

**Joint Public Hearing On Community Reinvestment Act Regulation
Chicago, Illinois – August 12, 2010
Testimony of Frank Ford**

Introduction

In 1977 Congress passed the Community Reinvestment Act (CRA) in response to urban decline and disinvestment brought about by the failure of – and in some cases deliberate refusal by – depository banks to make mortgage credit available to homeowners and homebuyers in inner city markets. These practices were commonly referred to as “red-lining”. Accordingly, CRA regulations have been focused on insuring that depository banks are meeting the credit needs of the communities they serve. These regulations have required banks to undergo periodic examination to determine if credit needs are being met.

I’ve been working in the field of urban community development since 1976 and have had the opportunity to observe the adoption of CRA and its application of the law and regulations over time. While at the University of Colorado in the 1990s I developed a curriculum for CRA training, and published studies on mortgage lending discrimination. In the past decade my day-to-day work has been deeply involved with the foreclosure crisis.

Based on this cumulative experience, it is my opinion that today, 33 years after the passage of CRA, *depository banks regulated by CRA are still causing significant damage and disinvestment to communities*; in fact, a case can be made that the damage today is far greater than during the height of the “red-lining” of the 1950s, 60s and 70s. The policies and practices employed by banks that are causing this damage have changed, but *the law and its regulations have not changed to meet the changing times*.

The observations I’ll share with you today are largely based on my direct and personal experience in Cleveland, Ohio over the past 11 years. As such, they may be applicable to other mid-western and eastern post-industrial cities that have been hard hit by the foreclosure crisis. I will not attempt to address the circumstances affecting other regions with different real estate markets.

In order to understand the new wave of damage being done to communities it is important to understand *two relatively new roles* that depository banks play today that were not a factor during the period when CRA was first adopted. In addition, it is important to understand *four activities* banks are engaged in – through either or both of these roles – which were also not a focus of attention during the early days of CRA.

Roles – Beyond Loan Originator

At the time of its adoption the focus of CRA was on a bank's role as a lender, an "originator" of mortgage loans. The two additional roles I reference are, technically speaking, not new but they have taken on new significance in terms of their role in community disinvestment since the emergence of subprime lending in 1995 and the subsequent foreclosure crisis.

1. Designated Owner of Mortgages in Securitized Loan Pools. The vast majority of mortgage loans foreclosed upon in Cleveland over the past decade were sold within days after they were originated. In most cases those mortgages were purchased in the name of a depository bank, acting as a trustee for a securitized mortgage loan pool. In a smaller percentage of cases, the mortgages were purchased directly by financial institutions in their own name, which would include depository banks purchasing in their own name. A study conducted by Case Western Reserve University in 2008 (Attachment 1) reveals that depository banks were the most frequent initiators of foreclosure lawsuits against subprime borrowers in Cleveland. Another measure of foreclosure activity – not limited to foreclosure on subprime loans – is seen in the frequency of financial institutions acquiring property at post-foreclosure Sheriff Sales. As indicated by more recent research conducted by Case Western Reserve University (Attachment 2) the top 20 purchasers at Sheriff Sale in 2009 were predominantly depository banks regulated by CRA. It is worth noting that the single largest share of properties was purchased by Fannie Mae (15%). Since these purchases frequently represent mortgages that were foreclosed by banks, the actual number and percent of foreclosure sales precipitated by depository bank foreclosures would even be higher than indicated. In their role as owners of mortgages and, after foreclosure, owners of the properties that were secured by those mortgages, depository banks have legal responsibility for the outcome of foreclosure litigation and the condition of properties to which they take title after foreclosure.

2. Servicer of Mortgage Loans. Thirty to forty years ago it was more common for a financial institution to service its loans in-house. Servicing appears to have emerged as a specialized line of business since the rise of securitized mortgage loan pools. Today depository banks frequently have servicing operations through which they not only may service their own loans, but the loans of other financial institutions. As indicated by research produced by MortgageStats.Com (Attachment 3) depository banks are the primary mortgage servicers for residential mortgages in America. The two primary services provided are 1) debt collection services, which include initiating and managing the foreclosure litigation, and 2) management and disposition of foreclosed properties taken into a financial institution's "REO" (Real Estate Owned) inventory at the conclusion of the foreclosure process. Pooling and servicing agreements for securitized loan pools often delegate to the mortgage servicer the authority to make decisions concerning the foreclosure litigation, as well as post-foreclosure disposition of property. Thus, even when they do not own or have a legal interest in a mortgage, or a property taken into REO, a depository bank that chooses to function as a mortgage servicer is in a position to make decisions that will substantially impact communities affected by foreclosure.

Activities That Promote Community Disinvestment – Beyond Loan Origination

Whether in their role as holding title to a mortgage (in their name or as trustee) or in their role as a servicer for mortgages, depository banks are engaged in four activities that were not envisioned by CRA but which contribute substantially to community decline and disinvestment.

1. *Unsound Business Approach to Foreclosure.* When CRA was adopted, foreclosure and the vacant property that flows from foreclosure were insignificant compared to the magnitude of the problem that has emerged since lenders began to stray from the “safe and sound” underwriting called for by CRA. Today depository banks as an industry, whether it be as owners or servicers of mortgages, are the chief decision-makers determining whether a home will remain occupied, or become abandoned. It is not uncommon to see a servicer refuse to write off \$20,000 in principle that would have made a \$100,000 loan viable, and would have enabled a home to remain occupied. After the home is abandoned, the servicer then finds they can only sell it for \$10,000 resulting in a greater loss than if a portion of the principle had been written off. This kind of unsound business practice damages not only the investors backing the mortgage, but the homeowner who was forced out, and the neighbors who live near the foreclosed house. Because of these practices, depository banks often find themselves sitting on large inventories of blighted REO property, the only buyers for which are wholesale investors buying in bulk. Banks would be better off embracing a wholesale approach to loan modification, rather than a wholesale approach to large inventories of abandoned property.

2. *Ownership In Violation of Criminal Codes.* It is a virtual certainty that once a home has been emptied out by foreclosure it will deteriorate – either from vandalism that may occur within hours of vacancy or from the slower effects of exposure to seasonal weather without the benefit of heat and routine maintenance. In Cleveland, as in most jurisdictions, as soon as a bank takes title to a property they are criminally liable for any failure to keep the property up to code, both inside and out. Yet, these codes are routinely ignored by depository banks taking title to REO property, often claiming “we’re only the Trustee, not the owner”. In many jurisdictions, Ohio being one of them, a trustee whose name appears on a deed is the party held liable. Another common defense presented by banks is “although we’re the owner, our hands are tied – it’s the servicer who has authority to make these decisions”. The irony of this statement is that most of the major depository banks that hold title to REO property are also the servicer for other properties held by other banks. Whether in their role as owner, trustee, or servicer, the blatant and criminal violation of housing codes by depository banks is a slap in the face to responsible homeowners held to the same standards, and is major contributing factor to community decline and disinvestment. A graphic example of a depository bank’s failure to comply with Cleveland housing codes can be found in a video posted on YouTube at <http://www.youtube.com/watch?v=Tf0iFTCbJQ>. [Ctrl + Click]

3. *Irresponsible REO Disposition.* Over the past two years, as foreclosing lenders have begun to wake up to the realization that they’re responsible for growing inventories of abandoned and blighted homes, one of their responses has been to “dump” these defective properties to anyone willing to pay nearly any price. A new sub-industry has emerged comprised of several dozen investors, typically operating outside of Ohio, who specialize in making bulk purchases of extremely low value distressed property from

lenders. Research from Case Western Reserve University demonstrates that, once again, depository banks lead the way in irresponsible dumping of low value distressed property (Attachment 4). Many of the investors who buy these properties know each other and often trade properties back and forth between their companies. Few of these properties are substantially renovated; some are leased or sold by land contract to low income buyers with little or no repairs; others are posted on the internet for sale with no repairs. As of December 31, 2009 fifteen of these out-of-state investors accounted for just over \$4,000,000 in delinquent property tax in Cuyahoga County. When depository banks dump these blighted and damaged homes, it's equivalent to putting defective and unsafe consumer products out in the stream of commerce. One positive development is represented by recent agreements by Fannie Mae and HUD to remove all of their low value property from the Cleveland market, and instead transfer them for \$100 or less to Cleveland's new land bank, the Cuyahoga County Land Reutilization Corporation. These agreements represent a model for responsible REO disposition that all other financial institutions should be encouraged to emulate.

4. “Walking Away” From Foreclosure. The most recent – and troubling – response of foreclosing lenders to their growing liability for REO property is to abandon the foreclosure process prior to taking title to the property. This practice, now widely referred to as a “bank walk-away”, can take several forms: 1) dismissing the foreclosure lawsuit prior to obtaining final judgment, 2) obtaining judgment but not requesting a Sheriff Sale, 3) requesting a Sheriff Sale but withdrawing the property prior to the date of sale, and 4) allowing the sale to proceed, but not bidding the amount of the lien when there are no other bidders. The common fact in all of these variations is that title never passes to the foreclosing lender, but remains in the name of the borrower who abandoned the home. The borrower typically thinks the foreclosure progressed to conclusion and they no longer own the home. No research has yet been done that identifies which of these 4 scenarios is occurring with the most frequency, or whether any specific lenders or banks are more likely to engage in the practice. However, I have personally attended two Sheriff Sales in the past month and on both occasions nearly one third of the approximately 150 sales were listed as “withdrawn” on the morning of the sale. With only a few exceptions each withdrawn sale was a foreclosure brought by a depository bank.

A common theme in all 4 of the activities described earlier is a lack of responsibility on the part of the foreclosing lender for the condition of the property pledged as collateral for the mortgage loan. Significant damage is done to communities when financial institutions initiate actions which cause the emptying out of a home, expose it to vandalism and deterioration, while assuming no responsibility for the cause and effect of these actions. Municipalities, non-profits, and individual neighbors are left to pay for the clean-up in the wake of these irresponsible business decisions.

Recommendations

The following recommendations are presented to address the community deterioration and disinvestment caused or aggravated by the activities described above. There is a need for a new lens through which bank reinvestment and disinvestment is viewed. The

present system of CRA examination and rating does not adequately take into consideration depository bank activity which is harming communities.

1. Servicing Activity. First, mortgage servicing activity clearly has a substantial impact on communities, and yet it is not captured in any publicly accessible database, and is essentially “off the radar”. a) Depository banks should be required to disclose the specific addresses of REO property they service, and the names and phone numbers of the individuals responsible for the property. [The MERS data system, a voluntary system proposed and maintained by the mortgage lending industry, is not sufficient. This must be mandated by Federal law and regulation.] b) When a bank is examined the exam should include a review of its mortgage servicing activity and the extent to which that activity is precipitating property abandonment and harmful REO disposition practices.

2. Complying With Criminal Housing Codes. a) There should be a bold statement from regulatory agencies that unequivocally acknowledges that failure to comply with local housing codes is a criminal activity which causes community disinvestment and will not be tolerated by any of the regulatory agencies. b) Examination of regulated banks should include a review of the condition of property acquired and held in the bank’s REO inventory. c) Examiners should contact local code enforcement officials to invite their comment during an examination.

3. Promoting Responsible Disposition of Property. a) Regulatory agencies should issue an “REO Code of Conduct” as a guide for regulated institutions (see sample at Attachment 5). b) Examination of regulated banks should include a review of sales of REO property, and whether the outcome of sales promotes or detracts from beneficial community reinvestment. c) Examiners should consult with municipalities and local community development practitioners and invite them to comment during an examination. d) Regulatory agencies should reward financial institutions that adopt programs that divert low value distressed property to beneficial owners like local land banks and municipalities, as pioneered by the Fannie Mae and HUD agreements with the new Cleveland land bank.

4. Taking Responsibility for the Condition of Mortgage Collateral. A lender contemplating filing a foreclosure action should be confronted with this question: If we proceed, and our actions cause this home to be abandoned, are there any negative financial consequences to us? Right now there are virtually none, and this fact alone is doing substantial damage to communities. Ideally, foreclosing lenders should be a) required by law to be responsible for the condition of the property if it becomes vacant at any time during the foreclosure process, or b) required to post a bond sufficient to insure against the costs that a municipality might incur for nuisance abatement or demolition. c) If neither a) nor b) are within the power of the Federal government then at minimum regulatory agencies should let it be known that bank examinations will include a review of the extent to which a bank’s foreclosure and loss mitigation practices are contributing to property decline and deterioration, and d) there will be adverse consequences with respect to a bank’s CRA rating.

In closing I would first like to thank you for the opportunity to testify today. But I would also suggest that you consider convening a similar hearing in Cleveland. Cleveland was hit hard by the foreclosure crisis and hit earlier than many other cities. Because of this Cleveland has had time to develop a variety of innovative approaches. A hearing based in Cleveland would afford you an opportunity to hear from a broader range of people with direct experience.

Thank you.

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Attachment 1

Top 20 plaintiffs on foreclosure filings on subprime loans. ¹	
Plaintiffs	Percent High Cost Loans, with Foreclosure
1 Deutsche Bank	30.72
2 US Bank	19.24
3 Wells Fargo ²	8.86
4 HSBC	7.68
5 Bank of New York	4.05
6 LaSalle Bank	3.80
7 MERS ³	2.36
8 Novastar Mortgage Inc	1.52
9 Wachovia Bank	1.52
10 JP Morgan Chase	1.43
11 Citi	1.18
12 Argent	1.01
13 New Century Mortgage Company	1.01
14 Avelo Mortgage	0.93
15 Indymac Bank	0.93
16 Countrywide	0.84
17 Property Asset Management Inc	0.84
18 Ameriquet	0.76
19 EMC Mortgage Company	0.76
20 Washington Mutual Bank	0.76
¹ Based on a review of court records for a random sample of subprime foreclosures (n=1,185). ² Includes Wells Fargo subsidiaries. ³ MERS is not a lender but a network of securitizers and servicers. Source: Cuyahoga County Clerk of Courts	

“Pathways to Foreclosure”, 2008. The Center On Urban Poverty and Community Development, Mandel School of Applied Social Sciences, Case Western Reserve University.

Attachment 2

Top 20 Buyers at Cuyahoga County Sheriff Sale 2009		
Buyer	Count	Percent
FANNIE MAE	726	15%
DEUTSCHE BANK NATIONAL TRUST	568	12%
US BANK NA	560	12%
WELLS FARGO	402	8%
FREDDIE MAC	232	5%
BANK OF NEW YORK	196	4%
HUD	184	4%
HSBC BANK USA and Affiliates	183	4%
CITIBANK and Affiliates	169	3%
BANK OF AMERICA and Affiliates	144	3%
PLYMOUTH PARK TAX SERVICES	107	2%
THIRD FEDERAL SAVINGS & LOAN	107	2%
AURORA LOAN SERVICES	76	2%
VETERANS ADMINISTRATION	76	2%
JP MORGAN CHASE BANK	70	1%
LASALLE BANK NATIONAL ASSOCIATION	69	1%
HUNTINGTON NATIONAL BANK	61	1%
ALLY Bank and Affiliates	50	1%
KEYBANK	48	1%

Research conducted for Frank Ford by the Center On Urban Poverty and Community Development, Mandel School of Applied Social Sciences, Case Western Reserve University, August 6, 2010.

Attachment 3

Top 10 Residential Servicers Ranked by Total Servicing Volume in 2010Q1 Dollars in Millions					
	Company	Location	2010Q1	Market Share	Depository Banks
1	Bank of America	Charlotte, NC	\$2,151,451	24.78%	24.78%
2	Wells Fargo	San Francisco, CA	\$1,797,759	20.71%	20.71%
3	Chase	Iselin, NJ	\$1,376,310	15.85%	15.85%
4	CitiMortgage, Inc.	O'Fallon, MO	\$699,782	8.06%	8.06%
5	Ally Bank	Detroit, MI	\$406,902	4.69%	4.69%
6	U.S. Bank Home Mortgage	Bloomington, MN	\$191,846	2.21%	2.21%
7	SunTrust Bank	Richmond, VA	\$176,108	2.03%	2.03%
8	PNC Mortgage/National City	Miamisburg, OH	\$154,099	1.77%	1.77%
9	PHH Mortgage	Mt. Laurel, NJ	\$153,060	1.76%	NA
10	OneWest Bank/IndyMac	Pasadena, CA	\$115,000	1.32%	1.32%
					81.42%

Source: data downloaded from MortgageStats.Com website on August 5, 2010.
According to MortgageStats.Com, market share information is based on an estimated total market size of \$8,682,005,000,000.
"Depository Bank" column added by Frank Ford.

Attachment 4

Top 20 Sellers of REO Property for less than \$10,000		
Cuyahoga County, 2008-09		
	Count	Percent
DEUTSCHE BANK NATIONAL TRUST	412	19%
FANNIE MAE	300	14%
US BANK NA	294	14%
WELLS FARGO	292	14%
BANK OF NEW YORK	134	6%
HSBC BANK USA and Affiliates	71	3%
LASALLE BANK	48	2%
PLYMOUTH PARK TAX SERVICES	41	2%
CITIBANK and Affiliates	40	2%
THIRD FEDERAL SAVINGS & LOAN	35	2%
WACHOVIA BANK	28	1%
KEYBANK	26	1%
BANK OF AMERICA and Affiliates	25	1%
NATIONAL CITY	22	1%
ALLY BANK and Affiliates	20	1%
AURORA LOAN SERVICES	18	1%
HUD	17	1%
FREDDIE MAC	16	1%
JP MORGAN CHASE BANK	16	1%
WM SPECIALITY MORTGAGE	15	1%

Research conducted for Frank Ford by the Center On Urban Poverty and Community Development, Mandel School of Applied Social Sciences, Case Western Reserve University, August 6, 2010.

Note: most HUD sales do not have a value recorded at the Cuyahoga County Recorder, thus the HUD count was likely significantly higher than the 17 indicated above.

Note: Although both Fannie Mae and HUD previously engaged in a significant volume of distressed low value sales, they have both since entered into agreements with the Cuyahoga County Land Reutilization Corporation (CCLRC) [new County land bank] to divert low-value REO property to the CCLRC. These agreements now represent a model for responsible REO disposition.

Attachment 5

A Proposed Code of Conduct For REO Owners and Sellers

[In 2008 an “REO Code of Conduct” was first proposed and adopted by the Greater Cleveland Vacant and Abandoned Property Action Council (VAPAC), a consortium comprised of City, County, Suburban and State governmental agencies, community development funders, CDCs, local universities and the Federal Reserve Bank of Cleveland. The following represents an updated draft presently under review.]

Some have compared the foreclosure epidemic to a Tsunami Wave that displaced tens of thousands of families. The initial wave left thousands of vacant homes in its wake. A Second Wave is represented by the irresponsible manner in which foreclosing lenders and investors are disposing and trading in vacant REO (Real Estate Owned) property.

Issues:

- An increase in foreclosures has meant an increase in REO property held by foreclosing lenders.
- An over-abundance of vacant blighted property has caused a drastic drop in home sale prices.
- A “churning” of vacant property...frequently changing hands among investors..... making it difficult for local authorities to find and hold owners accountable.
- An inability to find a contact person at the foreclosing lender or servicer – someone to contact for accountability or to acquire property for responsible redevelopment.
- Failure of the foreclosing lender to complete the case through Sheriff Sale, i.e. “walking away” after initiating the foreclosure and emptying out the home.
- Failure of the foreclosing lending to file its deed after taking title at Sheriff Sale.
- Failure to pay property tax and/or failure to maintain property to code.
- Sales of REO property to irresponsible investors who fail to pay property tax and/or fail to maintain property to code.
- Sales of property that should be condemned.
- Marketing materials and auctions that misrepresent the condition of the property.
- A re-emergence of Land Contracts and Rent-to-own scams to low income buyers.
- Unrealistic REO Broker Price Opinions that are geared to an investor market that will not bring properties up to code; e.g. failure to recognize that properties may have a negative value; responsible redevelopers who intend to bring properties up to code are at a disadvantage.

Elements of a Code of Conduct for Investor/Lenders/Servicers

- After filing foreclosure, if a home is abandoned, prosecute the foreclosure to its full conclusion, i.e. taking title at Sheriff Sale or other State authorized process.
- When taking title after foreclosure, promptly file the Sheriff’s deed or Deed in Lieu.

- Provide local municipalities and community development organizations with a point of contact that has authority to make decisions.
- Provide lists of REO property to municipal authorities and their affiliated land banks and/or community development organizations on a regular basis.
- Offer “low value” properties, e.g. \$25,000 or less [determined by local conditions] for donation to local municipalities or land banks, with additional cash payment to compensate for required demolition as determined by local authorities.
- In all other cases, prior to listing with a Realtor give a “first look” option to community development organizations and governmental Land Banks.
- Take properties off the market for 15-30 days while a first option is being considered.
- Make no bulk sales to flippers or speculators unless the local municipality has been given an opportunity to conduct an investigation, and has approved the investor.
- Unless otherwise approved by local authorities, make no sales (bulk or individual) to buyers who 1) are listed on governmental property tax rolls as delinquent, 2) have been fined or found guilty in connection with code violations on two or more properties, or 3) have failed to register their companies with the Secretary of State.
- Notify local authorities of all REO transfers.
- Comply with vacant property registration, point of sale and other ordinances.

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